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C O N F I D E N T I A L SECTION 01 OF 02 BAGHDAD 003088

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TAGS: ECON EFIN EPET PGOV IZ
SUBJECT: INITIAL 2008 BUDGET OFFERING SEEKS TO MINIMIZE DEFICIT SPENDING

REF: A. BAGHDAD OI OF 29 AUG 2007

¶B. MITMAN-RIES EMAILS

Classified By: Economic Minister Charles P. Ries for reasons 1.4 (b) and (d)

¶1. (C) Summary: The 2008 central budget negotiating season has begun. The Ministry of Finance (MoF) started the process in July with an austere first offer. Based on a very pessimistic oil export revenue forecast, the MoF's budget straight-lines security ministries and sharply cuts elsewhere, including provincial capital budget allocations. Finance Minister Jabr admits privately that at the end of the day budget allocations will go up, and the provinces in particular will receive as much as they did in the generous 2007 budget. The only likely big loser is said to be the Ministry of Oil, which is underperforming in budget execution this year. This of course is ironic given that the adequacy of budget revenues is closely tied to improving oil export volumes, and the Minister of Oil speaks publicly about bringing in foreign expertise on a service contract basis.

¶2. (C) The GOI is unlikely to meet the CPA-established "official" deadline of 10 October for submitting its budget proposal to the Council of Representatives (CoR) for debate and approval. It is ahead of last year's timetable however. Last year, executive branch negotiations were only completed in November with a final draft presented to the CoR on 26 December 2006. The 2007 budget was finally approved by the CoR on 8 February 2007. The draft budget complies with IMF requirements as outlined in the Stand-By Arrangement. We anticipate a lengthy and heated negotiation. End Summary.

Lower Revenue Forecasts and Continued Currency Appreciation

¶3. (C) The 2008 Budget Strategy is based on a forecast of Iraq's oil production at 2.1 million barrels per day, with expected exports of 1.6 million barrels per day at a price of 50 USD per barrel -- consistent with performance over the past two years. Initial oil revenue predictions for 2008 thus are 29.2 billion USD. With minimal additional sources of government revenue (direct and indirect taxes and interest), total government revenue is estimated to be 31.7 billion USD, compared to 33.4 billion USD predicted for 2007, a decrease of 5.1 percent largely based on the straight-line price of 50 USD per barrel for oil the GOI used in last year's budget. The strategy also assumes the Central Bank of Iraq (CBI) will continue to appreciate the Iraqi Dinar (ID) to combat inflation, and so is based on a 1200 ID/USD exchange rate.

¶4. (C) While the budget notes potential increased revenue from taxes on cellular telephone usage, forecasted non-oil revenues only total 2.48 billion USD, representing growth of

only 1.05 percent when compared to the estimated non-oil revenue for 2007 (2.36 billion USD). Further, the 3.75 billion USD generated by the August 2007 auction of the cellular telephone licenses is not reflected in the budget forecast or in Development Fund for Iraq (DFI) balances. Beginning in late August, the northern export pipeline came online, which, contingent upon the GOI's ability to secure and maintain it, represents a potentially significant source of additional revenue. Still, with the dilapidated state of Iraq's oil infrastructure and the constant threat of pipeline interdiction, the MoF's conservative revenue estimates may prove warranted. (Note: Over the four years prior to August 2007, the northern pipeline operated less than 90 days. End Note.)

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Provincial Capital Allocations Down...MoD and MoI even
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¶5. (C) In light of the provinces' promising ability to execute their 2006 and 2007 capital investment budgets, we are dismayed by the approximately 22.3 percent decrease (relative to the previous year) in proposed provincial capital investment spending. In 2007, the provinces were allocated nearly 2.4 billion USD for capital projects while this initial budget proposes an allocation of merely 1.85 billion USD. In a 28 August meeting, however, FinMin Bayan Jabr told Ambassador Crocker in confidence that he anticipated the final budget figures for 2008 would match or exceed the 2007 budgeted allocations for provincial capital investment (Ref A).

¶6. (C) Total combined budgeted operating expenditures in security-related ministries (Defense and Interior) are identical to their 2007 allocations, but the allocation for

the Ministry of Defense is down 1.2 percent, and the Ministry of Interior is up 1.5 percent. Given the overall decline in planned spending, FinMin Jabr underscored the level budgets for the security ministries as indicative of the importance he placed on them. Oil and Electricity are due to receive a paltry 1 billion USD each for capital investment spending, representing a drop of approximately 58 and 28 percent respectively from 2007 levels. In a conversation with EMIN in mid August, FinMin Jabr indicated that he anticipates that the ministerial capital investment budget for 2008 will see significant increases before a finalized budget is completed. He implied that, given Electricity's proven ability to execute its capital budget when compared to Oil, the Ministry of Electricity's final capital budget would exceed Oil's.

Inflation May Necessitate Budget Increase

¶7. (C) The initial Budget Strategy for 2008 outlines non-security operating expenditures to grow from 23.6 billion USD in 2007 to 25.2 billion USD in 2008, an increase of approximately 7 percent. With year-on-year inflation running between 20 and 30 percent and the GOI scheduled to assume operating costs for a large number of heretofore USG-financed facilities, the final budget for 2008 will need to increase substantially from this first offering.

¶8. (C) According to the Financial Management Law (CPA Order 95), the MoF in coordination with the Council of Ministers (CoM) theoretically must submit the final draft of the budget law to the Council of Representatives by 10 October. We do not anticipate the GOI making this deadline, as it has routinely fallen behind the Financial Management Law schedule. For the 2007 budget, the CoM did not submit the budget to the CoR until 26 December 2006, and the CoR did not pass the final budget until 8 February 2007.

¶9. (SBU) Comparative Annual Budgets: 2007-2008*

	2007 Final Budget	2008 Preliminary Budget	Percent Change
Revenues			
Oil Exports (Million Barrels per Day)	1.7	1.6	-5.9
Oil Price Realization (Price per barrel)	50	50	0.0
Oil Export Revenues	31,000	29,200	-5.1
Other Revenues	2,400	2,500	4.2
Total Revenues	33,400	31,700	-5.1
Operating Expenditures			
Non-Security	23,600	25,200	6.8
Security:			
Ministry of Defense	4,150	4,100	-1.2
Ministry of Interior	3,250	3,300	1.5
Subtotal Security	7,400	7,400	0.0
Total Operating Expenditures	31,000	32,600	5.2
Fiscal Balance before Investment Expenditures	2,400	(900)	-137.5
Investment Expenditures			
Direct Provincial	2,400	1,850	-22.9
Oil Sector Investments	2,400	1,000	-58.3
Other	5,300	1,700	-67.9
Total Investment	10,100	4,550	-55.0
Overall Fiscal Deficit	(7,700)	(5,450)	-29.2

*Amounts expressed in USD millions unless otherwise noted. For 2007 budget calculations, the official exchange rate of 1260 ID/USD was adopted and for 2008, the exchange rate adopted was 1200 ID/USD.

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